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## TABLE OF CONTENTS

<b>SUMMARY . . . . .</b>	<b>i</b>
<b>A. Comments Filed By Various Franchising Authorities. . . . .</b>	<b>2</b>
1. Evasion Is Per Se Unlawful. . . . .	2
a. The FCC Has Exclusive Jurisdiction To Identify Rates For CATV Service Which Are "Unreasonable". . . . .	2
b. CATV Operators Have Apparently Sought To Evade The Congressional Purpose In Enacting The Cable Act. . . . .	4
(i) Evasion through price gouging. . . . .	4
(ii) Evasion by recapitalizing. . . . .	6
c. Joint and Common Cable Plant Costs. . . . .	8
2. Leasing of CATV Converter Boxes and Remote Controls. . . . .	10
3. Procedural Matters Raised. . . . .	11
a. The Thirty Day Review Period. . . . .	11
(i) FCC Certification is a final Order. . . . .	13
(ii) Change orders for service at actual cost. . . . .	13
<b>B. Comments Of Broadcast Industry Representatives. . . . .</b>	<b>13</b>
<b>C. Comments Of Other Groups And Trade Associations. . . . .</b>	<b>14</b>

## SUMMARY

Many hundreds of Comments have been filed in this proceeding. In their initial Comments the Franchising Authorities noted that they appeared before the FCC as the voice of the people (vox populi). Franchise fees are a percentage of the gross income received by the CATV operators. Were not the intent of the Franchising Authorities to see that the people received the full benefit of the Cable Act, then private interest would have been a motive not to file any Comments at all. Since the Franchising Authorities filed many Comments, the FCC should view these Comments as free from the motive of self-interest. Ergo they are truly vox populi.

The Cable Act precludes CATV operators from evasion. Three forms of evasion have occurred since enactment of the Cable Act in October of 1992. First, unreasonable rate increases have occurred. The FCC is mandated by the Cable Act to consider any complaint filed for a rollback and refund to correct such rate gouging tactics. Second, CATV systems are being sold for the astronomical sum of \$2,888 per subscriber. The FCC's rules must prescribe that actual plant cost, not recapitalized cost, is the basis upon which maximum reasonable rate of return is calculated. Finally, CATV systems are being purchased so as to be used as the nucleus for adding other services such as Personal Communications Service ("PCS"). The rules the FCC adopts must preclude any cost which is not directly related to the

provision of CATV service being included in the CATV rate base.

The practice of CATV operators of leasing a remote control or other similar device and precluding its sale is so outrageous that the fact it is insidious is res ipsa loquitur.

The period of time afforded to review CATV rate increases must be at least 90 days. FCC certification of Franchising Authorities must be a final order. Orders for change of CATV service where the CATV system is computer controlled should be either free or at minimal actual cost.

Other Comments were filed by those whose interests should be viewed as motivated more by private interest than by public interest.

Before the  
**Federal Communications Commission**

Washington, D.C. 20554

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In the Matter of )  
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Implementation of Sections )  
of the Cable Television )  
Consumer Protection and )  
Competition Act of 1992 )  
 )  
Rate Regulation )  
 )  
To: The Commission )

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

MM Docket No. 92-266

**REPLY COMMENTS OF SMITHWICK & BELENDIUK, P.C.**  
**ON BEHALF OF VARIOUS FRANCHISING AUTHORITIES**

On behalf of various Franchising Authorities<sup>1</sup> Smithwick & Belendiuk, P.C. hereby respectfully submits its Reply Comments in response to the Comments<sup>2</sup> filed in the above captioned proceeding. Review of the various Comments supports the inescapable conclusion by the Franchising Authorities that in many instances, since the enactment of the Cable Act<sup>3</sup> on October 3, 1992, there has been established a pattern of evasion by some CATV operators.

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<sup>1</sup> The firm of Smithwick & Belendiuk was retained to file Comments in this proceeding by the CATV franchising authorities of the cities of Bowling Green, Kentucky; Carson, California; Conneaut, Ohio; Drexel, North Carolina; Key West, Florida; McKinney, Texas; New Bern, North Carolina; Paducah, Kentucky; Parsippany, New Jersey; Port St. Lucie, Florida; St. Petersburg, Florida; Salisbury, Maryland; and Williamston, North Carolina. (The Franchising Authorities)

<sup>2</sup> While counsel for the Franchising Authorities reviewed over a hundred Comments filed this proceeding, many Comments were not available for public inspection in time to permit review of all Comments.

<sup>3</sup> The Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, 106 Stat. 1460 (1992) (The Cable Act).

This pattern of evasion appears to be designed to defeat the very goal Congress sought to achieve when it enacted the Cable Act, i.e., to see that basic service tier rates for CATV service are reasonable and that the secondary service tier rates are not unreasonable.

A. Comments Filed By Various Franchising Authorities.

1. Evasion Is Per Se Unlawful.

a. The FCC Has Exclusive Jurisdiction To Identify Rates For CATV Service Which Are "Unreasonable".

A dispute about whether the provision of the basic tier of CATV service is at "reasonable" rates can be adjudicated either: (1) by a FCC certified franchising authority or (2) by the FCC itself. However, when dealing with a Complaint that involves unreasonable rates and rollbacks only the FCC has jurisdiction. Section 623(c) of the Cable Act (47 U.S.C. § 543(c)) gives the FCC 180 days after enactment of the rate regulation rules to identify rates for "cable programming services" that are unreasonable.

"Cable programming service" means any video programming carried on the CATV system, other than the basic service tier or on a per channel or per program basis. (47 U.S.C. § 543(1)(2)). As of April 1, 1993, many CATV operators will start to offer a basic service tier at a separate rate. For example, the CATV system serving Montgomery County, Maryland will subdivide its "preferred" service package, which now combines both the basic service tier and the second service

tier as a bundled unit for \$28.17 a month, into a bifurcated offering by which the new basic service tier is to be offered for \$10.65 per month. This is a classic example of what the Congress meant by the term "retiering." Thus, if the rates for the preferred service tier are "unreasonable" when the rate regulation rules are adopted, the FCC has the jurisdiction to roll back the rates that are determined to be unreasonable.

Because of the use of the term "180 days", the statute can only be construed as retrospective and not prospective in nature. Prior to April 1, 1993, there was no separate basic service tier offering, but only the "preferred" service offering. If the rates for CATV service existing as of March 31, 1993, were "unreasonable," then the FCC is empowered to order both rollback and refund so long as the Complaint is filed within 180 days of the enactment of the rules. (approximately October 1, 1993)

It therefore follows that the actions of certain CATV operators to substantially raise rates after October 3, 1992, in order to evade an FCC Order that the rates be rolled back and a refund made is merely a futile gesture. To interpret the Cable Act to give the FCC solely the jurisdiction to order a rollback and refund over CATV rates enacted on or after April 1, 1993, would require that the Cable Act be interpreted as affording only prospective relief. Were this so, then 47 U.S.C. § 543(c)(3) (which

tolls Complaints so that after 180 days only rates initiated after the effective date (April 1, 1993), including rates resulting from retiering) would be the proper subject of a Complaint and would be superfluous language in the Cable Act. The Congress must have intended that this 180 day window to seek "rollback" and "refund" apply to any "unreasonable" rate for CATV service existing prior to April 1, 1993. Clearly, in cases where there were substantial rate increases, but neither CATV plant nor programming services added, those post October 3, 1993 rate increases should be presumed to be an unreasonable rate designed for purposes of evasion. Otherwise the Congress would not have given the FCC authority to "rollback and refund" as of the date the rules are enacted, i.e., April 1, 1993. There would be nothing to rollback and refund if the Cable Act is not meant to provide retrospective relief.

b. CATV Operators Have Apparently Sought To Evade The Congressional Purpose In Enacting The Cable Act.

(i) Evasion through price gouging.

Many franchising authorities in their Comments noted that since the enactment of the Cable Act on October 3, 1992, there have been a proliferation of rate increases by CATV operators. The Comments filed by such communities as Thousand Oaks, California; Palm Desert, California; and Tallahassee, Florida; note that there have been substantial rate increases in their communities for CATV service since



the enactment of the Cable Act. All such Commentors urged the Commission to order a blanket rollback to rates existing before the enactment of the Act, i.e., the rates as of October 1, 1992.

The Congress foresaw that the problem of evasion might occur. In order to prevent evasion, the Congress gave to the Commission the unique authority to prevent any such evasion when it enacted Section 623(h) of the Cable Act (47 U.S.C. § 543(h)), which reads as follows:

(h) Prevention of evasions. - Within 180 days after the date of enactment of the Cable Television Consumer Protection and Competition Act of 1992, the Commission shall, by regulation, establish standards, guidelines, and procedures to prevent evasions, including evasions that result from retiering, of the requirements of this section and shall, thereafter, periodically review and revise such standards, guidelines, and procedures.

As the Conference Report<sup>4</sup> makes clear, both the Senate bill<sup>5</sup> and the House Amendments direct the FCC to adopt rules "to prevent evasions of the rates, services and other requirements of this section..."<sup>6</sup> The Conference Report<sup>7</sup> notes:

The conference agreement amends section 623(i)[h] to include a reference to evasions that result from retiering as a specific type of

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<sup>4</sup> H.R. Rep. No. 862, 102 Cong. 2d Sess. (1992). ("The Conference Report")

<sup>5</sup> Conference Report at 59.

<sup>6</sup> Conference Report at 61-62.

<sup>7</sup> Conference Report at 65.

evasion that the Commission should consider in establishing standards, guidelines, and procedures to implement the bill. The conferees recognize that many cable operators have shifted cable programs out of the basic service tier into other packages and that this practice can cause subscribers' rates for cable service to increase. The conferees are concerned that such retiering may result in the evasion of the Commission's regulations to enforce the bill. The conferees expect the Commission to adopt procedures to protect consumers from being harmed by any such evasions. In adopting regulations to implement this subsection, the conferees intend that the Commission also adopt regulations to prevent cable operators from evading the "anti-buy-through" provision of the bill.

The original House Report<sup>8</sup> gave specific examples of what the Congress meant by evasion:

Subsection (i)[h] is designed to give the FCC broad regulatory authority to prevent the retiering, repricing and other service or equipment charges required or permitted under this section from resulting in unreasonable rates for any cable service. Particularly, the Committee intends that the FCC in no way condone any sort of evasion or manipulation of the rate provisions of the legislation, such as a manipulation of tiers, bundles, or any other combination or fragmentation of programming in violation of the rate provisions. For example, the Committee intends for the FCC to view a change in cable service from one tier offering a broad package of programming for \$15/month or two tiers offering the same programming for \$5/month (for the basic service tier) plus \$15/month (for an expanded basic tier) as a \$5/month increase. The Committee notes, however, that an increase in rates such as that described above is not, standing alone, dispositive of whether such increases would be unreasonable under this section.

(ii) Evasion by recapitalizing.

Other than the Franchising Authorities very few cities

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<sup>8</sup> H.R. Rep. No. 628,102 Cong. 2d Sess. (1992) ("The House Report")

commented on the insidious practice in the cable industry of pricing services based on the purchase price of the cable system from a previous operator, rather than the actual cost of the plant used to provide CATV service. In their comments the Franchising Authorities noted that when a common carrier acquires a telephone plant from a previous operator the calculation of the rate base uses the cost of plant as originally installed, minus depreciation (net plant). The Board of Regulatory Commissioners of the State of New Jersey in their Comment urged that neither good will nor property held for future use should be considered in the rate base. To permit them to be included would be to defeat the very purpose of the Cable Act to guarantee reasonable rates because the rate base would be inflated. The purchase price of a CATV system is often 300% greater than its construction cost.

As an example of such recapitalizing the Washington Post on Wednesday, February 10, 1993, reported that Southwestern Bell Corp. is buying Cable TV Montgomery serving 172,000 households in Montgomery County, Maryland for \$494 million. The article reflects that Southwestern Bell is paying the equivalent of \$2,888.00 per subscriber, which is considered a very high relative price. The average purchase price in the CATV industry is reported as being \$1,768.00 per subscriber. The article reports that Cable TV Montgomery has a total investment in both acquiring the

system and in additions to the plant of \$240 million, but Southwestern Bell is paying \$494 million for the Montgomery County Cable system alone. Thus, the purchase price will be at least some \$254 million more than actual plant cost.

If the Commission does not limit the amount which a CATV system can include in its rate base to the "net plant" in computing the maximum allowable rate of return, but allows inclusion of goodwill and other non-plant cost factors, the rate base on which the basic service tier is computed could be twice or even three times that which would be justified on normal methods of accounting.

Therefore, the Franchising Authorities submit that the rate base upon which a reasonable profit may be calculated must be limited to the actual cost of the equipment purchased, plus the cost of installation of the cable plant, minus depreciation, but not to include goodwill or other factors which would permit a \$240 million CATV plant to be carried on the books at \$494 million in value.

c. Joint and Common Cable Plant Costs.

Joint and common cable plant costs should not be permitted to include the cost of plant used to provide any service other than CATV service. The Cable Act scheme of regulation contemplates CATV service consisting of the basic service tier, second service tier and pay television channels. The Washington Post article on the Southwestern Bell purchase of Cable TV Montgomery indicates that one of

Southwestern Bell's purposes in doing so is to be able to use the cable system "to launch the next generation of cellular telephone service, 'Personal Communications Service' ("PCS")...." The providers of PCS service will be competing with cellular service operators. Both cellular service and PCS service are heavy capital intensive industries. The Commission rules should make it clear that the rate base for joint and common plant utilized for CATV service may not include any capital costs associated with any service offering other than CATV service.

Thus, in order to prevent such commingling of service offerings using common plant, the rules the Commission adopts in this proceeding should include a provision as set out herein. If the CATV operator wishes to provide any other service, such as PCS, which is not directly related to the provision of CATV service, it must do so in such a manner that both its capital costs and its operating costs for so doing are clearly separate on the books and records of the company as easily distinguished from the costs of plant and operating expenses used in providing CATV service. This would be the type of oversight which the Franchising Authorities, operating as a CATV policeman, would be in the best position to exercise to determine that the CATV operator's books of account are being maintained in accordance with the FCC rules. The Franchising Authorities would be able to file a complaint if any violation of these

rules were found.<sup>9</sup>

2. Leasing of CATV Converter Boxes and Remote Controls.

An almost universal practice of the CATV industry that the Franchising Authorities and some other Commentors found to be outrageous is the refusal of CATV operators to offer to sell converter boxes and remote control units at a reasonable price to their CATV subscribers. A typical cost for a remote control unit is \$25.00.<sup>10</sup> However, in Thousand Oaks, California the cable operator leases the remote control unit for \$3.50 per month; in Somerville, Massachusetts for \$3.95 per month and in Schaumburg, Illinois, for \$4.75 a month. It is obvious that no entrepreneur would pay \$2,880 per subscriber to purchase a CATV system were there a high rate of subscriber turnover. That portion of the purchase price indicates a payment in excess of over five years of the total gross payments of all subscribers to the CATV system, i.e., "goodwill". Yet the CATV subscriber desiring a remote control must lease one

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<sup>9</sup> Franchising Authorities would have no objection to the Commission's rules prescribing that the Franchising Authorities would have to execute a confidentiality agreement before inspecting the CATV's operator's books. But obviously, if as a result of the inspection there is a complaint filed with the Commission, the complaint itself and the underlying documentation in support of the complaint would become a matter of public record.

<sup>10</sup> Typically, if a CATV subscriber has to replace his broken remote unit he has to bring it to the Cable Company and pay them \$25.00 for a new unit.

from the cable operator during this five year period for a rate almost ten times the \$25.00 cost of the remote unit.<sup>11</sup> Thus, there appears to have been good reason for the Franchising Authorities in their comments to describe as "outrageous" the refusal to sell such units. There should be no hesitation on the FCC's part to issue rules which preclude such price gouging practices.

### 3. Procedural Matters Raised.

#### a. The Thirty Day Review Period.

Universally, Franchising Authorities reject the concept that a period of thirty (30) days from notification to the Franchising Authorities by the CATV operator of a proposed rate increase is sufficient to adjudicate any dispute. Whether 90 days, as some suggest, or 120 days as others suggest, is to be a goal will largely depend on whether it is a goal where achievement is in the best interest of both the CATV operator and the CATV subscriber. To achieve a balance, the period must be small enough that the CATV operator is not unfairly burdened while rate increases are delayed pending adjudication, and yet long enough to give the Franchising Authorities an opportunity to review the facts. There are five logical steps to this process.

(1) Actual notification, in writing, of the proposed rate increase by the CATV operator to the Franchising

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<sup>11</sup> \$210 for 60 months in Thousand Oaks and \$285 for 60 months in Schaumburg, Illinois.

Authorities at least thirty (30) days before its proposed effectuation with such supporting documentation as necessary to show that the basic service tier rate increase is reasonable and the second tier not unreasonable.

(2) Subsequent to that notification, notice must be given to the CATV operators by the franchising authority that the proposed rate increase is considered to be lawful, or that it appears to be unlawful. In the latter case, such notice would contain a bill of particulars. This notification would toll the effective date of the rate increase for sixty (60) days.

(3) The CATV operator should have thirty (30) days to respond to the Bill of Particulars filed by the CATV operator. Any requests for extension of time to respond shall be granted only if the effective date is further tolled.

(4) The franchising authority would have ten days to respond to the CATV operators response to the Bill of Particulars and the CATV system operator then would have ten days to reply.

(5) If the franchising authority concludes the proposed rate increase is unlawful, the increase would be permitted to go into effect, but the previous documentation would be filed with the FCC as a Formal Complaint seeking: (1) adjudication of illegality; (2) rollback; and (3) refund of unlawful charges including interest.



(i) FCC Certification is a final Order.

A franchising authority who is desirous of seeking FCC certification to regulate rates would be naturally concerned that FCC certification be considered a final order. Otherwise, the process of issuance of local franchising authority certification can itself be bogged down in needless review. Since the CATV operator is afforded due process by Section 623(5) (which permits revocation of the certification upon a showing of cause) it appears appropriate that the CATV operator not have legal standing to intervene in the initial certification process.

(ii) Change orders for service at actual cost.

Where the CATV operator's convertor box can add, subtract or cancel service through computer control, Franchising Authorities submit that there should be no charge for such change orders. Some charge may be reasonable if a subscriber requests more than one change during any month in order to discourage the possibility of abuse by adding or subtracting service to receive particular programming. Since the minimum charge is for one month the probability of this occurring is highly unlikely.

B. Comments Of Broadcast Industry Representatives.

As might be expected Comments filed by CATV operators favor a benchmark rate system by which industry rates, no matter how unreasonable, become reasonable by FCC fiat.

Continental Cablevision would have the FCC believe that CATV operators are virtually non-profit charitable organizations despite Congressional findings in the Cable Act to the contrary. Continental states: "Cable is financially organized for long term cash flow, system growth and capital appreciation, not for the immediate, steady earnings and dividend payouts that characterize LEC's."<sup>12</sup>

That is precisely the reason the CATV industry should be subject to rate of return regulation as to the basic service tier. The present system of no regulation permits a CATV operator, such as Cable Montgomery TV to purchase a CATV system in 1986 for \$40 million, to invest \$200 million in improvements and sell it six years later for \$494 million or \$2,888 per subscriber. If CATV rates had been reasonable ones then CATV systems would not be selling for \$2,888 per subscriber.

C. Comments Of Other Groups And Trade Associations.

The National Association of Broadcasters (NAB) filed extensive Comments that include an economic analysis which concludes that the benchmark rate for the basic tier of CATV service should be \$4.52 a month. However, the formula used to derive that figure does not appear to contain any maximum allowable rate of return figure. Moreover, the NAB's argument that cost of CATV plant should be replacement cost


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<sup>12</sup> Continental's Comments, Summary at i.

rather than actual cost is not only contrary to all rate regulation precedent, but is contrary to the public interest. If replacement cost were used instead of actual cost the CATV operator would have no incentive to upgrade his system because the rate base would always be calculated as if the system were state-of-the-art, rather than antique.

Many telephone companies filed Comments, but these seem more addressed to arguing that the public interest lies in letting LEC's provide CATV service rather than to the issues raised in this rulemaking and are thus irrelevant.

Respectfully submitted,

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